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Edinburgh

1859

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HOW TO MISMANAGE A BANK:

A REVIEW

OF THE

WESTERN BANK OF SCOTLAND.

EDINBURGH: ADAM AND CHARLES BLACK,
AND JOHN MACLAREN.

MDCCCLIX.

In July 1858, the Report of the Select Committee of the House of Commons on "Bank Acts" was issued, containing the details of the crisis of 1857 and of the bankruptcy of the Western Bank of Scotland.

It is not to be wondered at, though it is matter of regret, that with such a mass of conflicting evidence before them the Committee, persuaded "that no mischief will result from at least a temporary continuance of the present state of things," recommended no practical measure.

The following observations were written some months ago, after a careful perusal of the Report, and are now submitted to those interested in our banking system, in the hope that they may find in them something worthy of their consideration.

EDINBURGH, *November 1859.*

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THE WESTERN BANK OF SCOTLAND.

THE WESTERN BANK'S BALANCE SHEETS.

THE APPENDIX to the Report of the Select Committee of the House of Commons on the working of the Bank Acts, contains the Annual Accounts of the Western Bank from 1833 to 1857. It is interesting and instructive to look at the account for the last year, issued six months before the Bank closed its doors, and to think that behind these figures, showing an undiminished capital of £1,500,000, a rest of £240,000, and funds to pay a dividend of 9 per cent, there lay hid a loss of nearly THREE MILLIONS!

That account, presented to the meeting of shareholders in June 1857, showed them as possessed of property in the shape of capital and rest amounting to nearly £2,000,000, when subsequent events have proved that they really were losers to the amount of about £3,000,000. How is this enormous discrepancy to be accounted for? How were such losses concealed?

There are various ways in which an account can be falsified so as to conceal loss.

"The Liabilities" may be understated. Accounts which are entered in the balance-sheet may be entered erroneously, or liabilities which really lie on the company may be altogether omitted.

Or "the Assets" may be over-stated. They may contain large sums of money which never can be made good to the Company.

These various forms of error are all exemplified in the accounts of the Western Bank.

We give the account of June 1857:—

<i>Assets.</i>			
Credit Accounts	£1,932,024	3	1
Bills Discounted	2,873,293	19	1
Bills with Country Agents	266,272	19	1
Bills Lodged,	152,803	6	0
Balances due by London Bankers }	108,085	7	2
do. by Sundry do. }			
do. by Branches	594,283	12	1
Bills Protested	108,840	16	11
Sundry Debtors	283,661	16	3
Government and other Securities	232,542	7	6
Miller Street Property	49,608	13	9
Bank Note Paper	17,000	0	0
Stamps,	856	4	11
Law Expenses	3,000	0	0
Adjusting Account of Interest	14,307	7	7
Balancing of Cash	685,391	10	0
	£7,321,972	3	5

<i>Liabilities.</i>			
Capital	1,500,000	0	0
Notes issued	1,627,176	10	0
Deposits	741,119	12	5
Bills for Collection	309,157	18	3
Balances due to London Bankers			
do. to Sundry do.	49,129	4	3
do. to Branches	2,715,024	9	5
Sinking Fund	226,777	3	3
Guarantee Fund	20,106	13	10
Dividends	131,062	10	0
Unclaimed Dividends	2,418	2	0
	£7,321,972	3	5

To assist us in pointing out how so many millions were misstated in this account, we have the account of the Committee of Shareholders, of the state of affairs in December the

same year, where they estimate the loss on the whole operations of the bank at £2,000,000. Future investigations have proved that another million was lost beyond their estimate. Still, as that additional loss was not from any new source, but chiefly from under-estimating the damage the company would sustain from known sources, it is unnecessary to refer to more accurate statements subsequently issued.*

It is unnecessary to extract their vidimus in full; it may be sufficient to state that the loss of £2,000,000 was composed of the following items:—

1. On Bills	£437,945
2. On Current Accounts	885,837
3. Foreign Securities held for drafts accepted by the Western	60,000
4. On Past-due Bills and "Sundry Debtors' Account"	685,597
5. On "Other Securities"	22,347

The statement of the Liabilities of the Bank is open to the following remarks:—

1. CAPITAL	£1,500,000
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This account stood at these figures ever since Mr Taylor came into the management, yet it is evident that this was not the real capital of the bank. In December 1857, 2,569 shares had been purchased by the bank (equal to about £180,000), and were in hand.

Such shares used to stand in the balance-sheet among the "assets" as "company's stock." Mr Taylor seems to have slumped that account under the title of "government and other securities," at least so the figures lead us to suspect.

This misrepresentation, though it seems to lessen liability at first, threw the loss on a smaller number of shareholders and cost the shareholders £300,000.

2. NOTES ISSUED	£1,627,176	10	0
DEPOSITS	741,119	12	5
BALANCES DUE BY BRANCHES	2,715,024	9	5

* The Liquidators' account, submitted on 4th Oct. 1858, estimated the loss at £2,793,356.

The misrepresentation these figures contain results from the principle on which the whole balance is framed, and which Mr Fleming, in his evidence before the Parliamentary Committee, thought of sufficient importance to notice to them. It is that the balance is simply that of "the Head-Office transactions," and all that has been done at the branches during the year, is concealed under the return of "Balances due to or by Branches." Much mischief may be concealed under such a return; for instance, a Branch may have £200,000 of deposits and £300,000 of bad debts—all that would appear would be an asset due by such a Branch to Head Office, £100,000!—yet when the settlement came there would be at that Branch £200,000 of debts to pay, and £300,000 lost, instead of an asset of £100,000.

So with "the Deposits" The deposits at Branches are not included. Some £4,000,000 of liabilities unnoticed!

"The Notes issued" included evidently those held by the Bank and its Branches. This is not the real amount of liability to note-holders.

The Western had a hundred and one Branches. The effect of such a false principle on the general result must have been very great.

If at any Branch the debts due to the Bank were all good it would not affect the result whether the balance only appeared or whether the liabilities and assets were separately stated, but the principle is decidedly objectionable, for it conceals what ought to be known. Because the business of the Bank was carried on at one hundred and one places, besides the Head-office in Miller Street, Glasgow, was that any reason why those responsible for the whole transactions of these one hundred and one Branches should only know the transactions at Miller Street and how that office stood with these numerous branches?

Evidently the plan adopted by the Committee was the only proper one, where the whole assets and liabilities of the establishment whether at Head-office or at the agencies, are brought under one view, where the total "deposits," the total sum of bills, of bad debts, the total sum of each species of debt due by or to the Bank, is fully specified.

There is nothing worthy of notice recorded on the side of

the liabilities, but there is a question most important to interpose here—*are these all the liabilities of the bank?* The answer to this is found in the account of the Committee of investigation. Under the statement of liabilities there is—

"3. ACCEPTANCES PAST, DUE, OR CURRENT."

The three first items of this kind show a responsibility for £920,654, composed chiefly of acceptances, or obligations to accept, foreign correspondents at New York and elsewhere.

Of course, the Bank had not expended any of that money, but claims to that amount were assuredly enforced against the Company ultimately, and the important point was, did the Bank hold Securities sufficient to guarantee the repayment of these advances? The Committee reported with their account, that there would be a loss on the securities held at New York, and it is since understood that the loss on these credits amounted to much more than the Committee anticipated.

The objectionable point, however, is the fact of liabilities of £1,000,000 really existing against the Company, and being totally ignored in the account. The whole million might have been a dead loss.

Another branch of business having heavy responsibilities attached comes out in this investigation too.

6. BILLS REDISCOUNTED

£1,073,771

These bills had now passed out of the hands of the Bank and out of their books, but they bore the endorsement of the Manager, and till duly retired the recourse against the Bank for repayment of any dishonoured bill was a true and serious liability which it was improper to conceal.

The importance of this will be seen practically when the facts are stated that the Liverpool Borough Bank had in London at the time of its failure bills rediscounted to the amount of £3,500,000, and that of these from £700,000 to £1,000,000 were discounted solely on the credit of the Bank's endorsement, which implies that the Bank would have a large proportion of that sum to refund.*

* See Mr Dixon's Evidence—Question 4209.

The Northumberland and Durham District Bank when it failed had rediscounted £1,500,000, of which £230,000 came back unpaid, and for which, of course, the company were liable. The Western Bank itself rediscounted during the three years preceding its stoppage about five millions annually. Surely it is a mockery to have such liabilities as these hanging on a company and omit all notice of them.

We do not enter on the question whether rediscounting its bills or accepting drafts on account of its customers be legitimate branches of banking business, but we insist that such responsibilities be fully and fairly exhibited in the accounting of the company.

The circumstance of neither of these species of transactions affecting for a time the cash of the firm, while it makes their existence more apt to be overlooked, renders strict investigation the more necessary.

Turning now to the other side of the account, THE ASSETS, let us look at the details. The danger here, and the one most frequently injurious to all bankrupts, is that of over-estimating their stock. It is most injurious here.

The first entry is:—

CREDIT ACCOUNTS, £1,932,024

This large sum is only what the Head Office advanced on current accounts. There was nearly £1,200,000 advanced by the Branches in October, but from the mode of presenting the balances due by or to the Branches instead of the details, this latter sum could not appear.

The most tangible distinction which could have been made here, is that advances "*unsecured*" ought to be separated from those that are in some way secured. From the report of the investigation, we find that there were at Head Office and Branches, nearly £600,000 of "over-drafts," that is, advances made to customers on their cheques, without any other security; more than £1,000,000 only partially secured, and about £300,000 on the security of Western Bank Stock!

Had these figures stood out before the eyes of the Directors they could not have been so blindly secure at their post. The real loss on these accounts is not known; the estimate was about 25 per cent. of the whole asset of £3,600,000, or nearly £1,000,000.

Such unsecured over-drafts very frequently issue in heavy loss. They are quite illegitimate in their nature. Many banks, by their constitution expressly forbid such advances.

"BILLS DISCOUNTED" is the next asset, £2,873,293

This is of course only the discounts of Head Office, and it is a very difficult item to handle, so as to come to any accurate idea of its composition.

The loss which accrued to the Western from these discounts was very serious. Almost the whole of the advances to the four bankrupt firms of Macdonald & Co., Monteith & Co., Wallace & Co., and Godfrey Pattison & Co., being in the form of discounts. The sums of their bills were respectively, £17,000; £469,000; £226,000; and £347,000: together, £1,459,000.

A considerable proportion of such bills were "Accommodation Bills."

Accommodation Bills, or bills for which no value has been received. Can any mode of accounting make these bills appear such as they are on a balance-sheet? We fear not; they ought never to be discounted, but if a bank does discount such bills, and either in ignorance or otherwise gives cash for them, they must be permitted to mix up with the other bills till some catastrophe brings them distinctly under notice. It has become a regular trade, to manufacture such bills; many persons seem to make a precarious livelihood by accepting for a small commission the bills drawn on them, on the understanding that the drawers retire such bills when due.

Renewed Bills, that is new bills substituted for former ones, to keep up an old debt, are, like the last noticed documents, dangerous, though very difficult accurately to discriminate. There seems no way so suitable as either to throw all "Renewals" into a separate account for such bills, or to mark on the face of the new bill the date and amount of the old debt.

Passing to the two items of the June Account, "Protested Bills," and "Sundry Debtors," their very titles and their amounts draw special notice, and prompt the inquiry, "of what are these accounts composed?" Glancing back through the annual balances, we see in their history a rather suspicious

circumstance. "The Protested Bill Account," up to 1847, was not very heavy in amount, though it was £66,000; but in 1848 it rises to £356,000. It may have struck the official eye that such a sum of "Protested Bills" was very unseemly; so next year, 1849, the following plan was adopted. A new account, called "Sundry Debtors," was raised in the ledger, and £345,000 being transferred to its debit, the protested bill account that year shrunk into the marvellously modest sum of £39,782! From that time to 1857, "Sundry Debtors" was a remarkably steady asset, appearing in every balance-sheet at about £300,000. What this lot of debts ten years old was worth in December, 1857, the committee of investigators will best be able to tell. Their valuation of that date makes a deduction of £685,000 from the amount of "Protested Bills" and "Sundry Debtors," leaving only £285,000 of these two accounts supposed to be recoverable!

The title of the account, "Sundry Debtors," with a sum of £300,000 standing at its debit from year to year ought to have excited suspicion, and drawn down investigation before ten years were suffered to elapse. What could it be composed of except irrecoverable debts! All the regular investments of banking business have been separately stated, "bills," "credit accounts," "government stock," and even "*other securities*." There seemed a strong presumption that this amount was an unsecured and *irrecoverable* debt.

There is one item more must be noticed, that is "government and other securities." It has ever been held as a fundamental principle of Scottish Banking, that a reserve, varying from one-third to one-fourth of the aggregate amounts of their note circulation and deposits, be held so invested in London, as to be available at all times on the shortest notice. Of course the bulk of such investments must be government stock. Now what light do these annual accounts throw on the practise of the Western on this point? Why, from 1833 to 1839 they seem to have held no government stock at all. Up to the balance of 1848, the balance-sheet never shows a larger sum invested in government stock and "other securities" than £53,000, and even till the close of their business, when they had near £6,000,000 of deposits and circulation together, the highest sum stated in that account is £282,000.

From that sum ought to be deducted the amount of "other securities." What their nature or quantity was we do not know, but we do know that the committee in December 1857, estimated a probable loss of £22,000 on these securities.

Such a course is all the more flagrant a violation of all the rules of both prudence and banking, that in 1838 the other Scotch banks remonstrated against such a system, and actually advanced some hundreds of thousands to the Western to purchase government stock, as the beginning of a sounder and better state of things.

HOW TO TEST THE SOLVENCY OF A BANK.

Instructed by this slight review of some more evident and most injurious errors in the book-keeping of this bank, let us endeavour to state two or three great leading principles, the steady and regular application of which would serve both to prevent mismanagement in any bank, and secure that, if it did take place, it would be known.

Is it not possible to make the state of a company's affairs so plain and intelligible, that any one of ordinary mercantile experience might understand it? Is it not possible to devise such a mode of exhibiting property, and the debts of a bank, that any one of the directors might see when the principles of prudence, which admittedly ought to regulate the conduct of such establishments, have been transgressed? We think both these things are possible.

But let it not be supposed that any formula can prevent deliberate fraud. If the manager or directors of a concern intend to deceive or conceal the details of their management, they will find some way of doing so, in spite of every check that may be imposed. Fortunately, it is not wilful imposition, in most cases, that is to be guarded against. In the majority of instances those who misdirected the business, did it through negligence or from some other motive than self-aggrandizement. Frequently they were gradually involved in some speculative undertaking, till, unable to set themselves free, they

sunk hopelessly deeper and deeper in ruin with those they at emptied vainly to support. Had some third party seen the beginning of such dangerous practices, and possessed the right to interpose, often the ultimate catastrophe might have been avoided.

With a few exceptions there never has been any ground to institute criminal proceedings against the directors or managers of even those establishments, whose failure has produced the largest amount of pecuniary loss and individual suffering.

The first check we suggest would be that with each balance sheet a list containing the name of *every debtor* at head office or branches, whose whole obligations to the bank, in whatever form, whether "discounts," "credits," or "overdrafts," exceed a definite sum, say £20,000 or £5,000, be exhibited. There are two important points involved in this proposal, first, give *the names and designations of the individual debtors*. Behind and below all the mystifications of book-keeping, all the high-sounding titles of "credit accounts," "bills discounted," or "sundry debtors," there always is some person or persons who have got the bank's money. Let us see them, let us know who they are, and we may have some chance of judging accurately whether they are worthy of such credit. Without the names of the debtors no real or just estimate can be formed of the security of the investment.

Next, it is not necessary that the name of every debtor should be given. That in a large establishment would be as good as none. Give us *all* who owe the bank more than £5,000, £10,000, or £20,000, and we will be pretty well satisfied.

It is a most safe principle of business to shun large risks. Insurance offices, who calculate risks with arithmetical accuracy, always limit their risk on any one policy to a very few thousand pounds.

In general, the larger the number of debtors the more sure is the debt. No bank perhaps was ever brought down by the failure of hundreds of small debtors. Therefore, though the bank may have a million on loan, if it is to a couple of thousand, or even a thousand debtors, none of whom have more than £2000 or £3000, and the majority a much smaller sum: with ordinary security it is safe, not from any loss, but

from any serious injury to the solvency of the establishment. It is unnecessary to examine the solvency of such debtors, to satisfy ourselves of the solvency of the bank.

On the other hand, large advances to any firm are undesirable; they cannot always be avoided, but the history of bank failures most loudly warns of the danger impending over the company that stakes half its capital on one concern. To illustrate this, we may refer to the Northumberland and Durham District Bank, with a capital of £600,000, which had £750,000 advanced to the Derwent Iron Company; the Western Bank of Scotland, who in 1857 had advanced their whole capital of £1,500,000, to four Glasgow houses. Further examination will confirm the fact that it has most frequently been when a bank is deeply involved with some one or two large customers that its credit is destroyed. In contrast, to show the safety of small advances, the best asset of the Northumberland and Durham District Bank consisted of £250,000, local trade bills, payable in Newcastle, "scarcely one of which exceeded thirty or forty pounds."*

The second check will be found in securing that any debt which has been outstanding longer than a definite time, say two years, be submitted in all its details.

Permanent loans are not legitimate banking, and wherever a sum has been on loan for years without repayment, the debt ought to be strictly investigated. But the important outstanding debts that such a regulation would effect, are those irrecoverable sums, which instead of being wiped off, are so often in unsound banks carried forward from year to year as a good asset, under some title or other which hides their real nature from the eye.

Now a *vidimus* of every debt of longer standing than two years, with the period when it was contracted, and its nature distinctly specified, would present materials to the eye of almost any director of a bank, sufficient either to satisfy him, or to lead to such further enquiries as to make the debt either good or bad.

It is obvious the check found in the date when the debt was incurred, would be quite ineffectual against advances in

* See K. D. Hodgson's Evidence, Question 3579.

slape of discounts, or an operative cash account, the sums in loan in these forms might be much too large, yet the date of the loan would not aid in forming a judgment of them. It seems sufficient to say, that it is not against such risks that this precaution is proposed, it is intended mainly to prevent a realized bad debt from being reckoned as a good one. In the cases of both the banks already referred to, large sums, totally irrecoverable, were carried forward from balance to balance as an asset.

Neither in this case is it necessary that the smallest sum outstanding for such a period be thus prominently brought forward; it might be quite sufficient to go as low as £1000, and investigate all debts of a larger amount.

The third avenue by which mischief enters, and which must be shut, is that which arises from a company having interposed its credit without having actually advanced the money. This is the case where the bank has either rediscounted bills or accepted bills. Neither of these species of transactions ever appear in the balance-sheets, and therefore it is the more necessary to secure that, if they exist, their quantity and quality are fully known.

To rediscount its bills is a resource to which a bank always resorts when hard pressed. Of course the bank has advanced money at one time on these bills, but the cash being returned when they are rediscounted, the bills are removed from the bank's books, but the responsibility of the company which the endorsement of the bill secures, remains till the bill is retired.

Unfortunately, when an establishment is in such circumstances, its bills are not of first rate quality, and frequently nothing but the signature of the bank on the back of the bill would give it currency anywhere. In these circumstances, the liabilities incurred by rediscounting are very serious. The case of the Liverpool Borough Bank illustrates this. When it stopped payment it had about £3,500,000 of bills in the hands of London bill-brokers, and of these from £700,000 to £1,000,000 were discounted solely on the credit of the endorsement of that bank! This must have entailed ultimately a heavy loss on the shareholders.

The same kind of responsibility exists in a more tangible

form, when a Bank accepts bills on account of some customer. In this case it is certain the advance must actually be made when the draft reaches maturity, and the safety of the transaction lies in there being ample security the sum will be refunded. The postponement of this arrangement makes it of course in a proportionate degree the more uncertain, and makes it the more absolutely necessary, that those who would ascertain the solvency of such business, have a full and distinct exposition of all such risks.

It is in these two forms chiefly that the credit of a bank is interposed, and towards these two points that investigation ought to tend. Is the bank's name on any bills in the hands of onerous holders? ought to be the question.

Lastly, there is one class of advances, in their nature opposed to the principles of strict banking, which cannot be omitted, namely, "*unsecured loans*" of whatever nature, whether overdrafts on current accounts, or advances made on the simple acknowledgment of debt in the form of a promissory note under the borrower's hand. These loans are doubly hazardous, and countervene the general rule never to make any loan without security. "Cash Account Bonds" have always two names at least besides the principal; all bills have more than one obligant, and so with all the other legitimate advances. It is not so with "over-drafts," nor with loans on the personal credit of the borrower alone, and therefore all such transactions, if not strictly forbidden, and they are occasionally unavoidable, require strict supervision.

Thus it seems by a careful deduction from past experience, that to prevent such calamities as have overwhelmed so many banks lately, directors or auditors ought to pursue their examination of a bank's affairs along the lines indicated by such queries as these:—

1. Specify the parties who are debtors to the bank a larger amount than £5000 or £10,000?
2. Specify the debts due to the bank of £500 or £1000 or upwards, which have been outstanding for a period of two or more years.
3. Specify the unmaturing liabilities of the bank, such as bills rediscounted, acceptances, &c.
4. Specify the "unsecured" loans of the bank.

It is implied in such an audit that there is no "private ledger" kept under lock and key by the manager, that the materials for the examination are honestly placed before the auditors, that they have not to detect deliberate fraud, that they are willing to spend some time in their investigation, so as to satisfy themselves, and that they are men of ordinary intelligence, experience and courage. In such circumstances, were the information which such inquiries would elicit fully and fairly exhibited, we believe that, besides securing that if anything was wrong it would be known, the far more important result would be attained of preventing such management from ever occurring.

BANK STOCK.

In the Report of the Court of Investigation of the shareholders of the Western Bank of Scotland in December 1857, the following sentences occur:—

"It will readily occur to those acquainted with the operations of a banking company, that in the present condition of this bank considerable loss may arise to the company from the position of the share list. According to the return given to the committee that list stood on the 11th December, as follows:—

"Stock authorized by the company in shares of £50 each, was 30,000 or £1,500,000.

Of these shares there were held in name of the bank,	1388
In name of others for behoof of the bank,	283
In name of Ayrshire Bank,	405
In name of various bankrupt estates,	493

2569

"The loss under this head cannot be estimated at less than £30,000."

Again—

In the examination of Mr Fleming before the committee of the House of Commons, question 5503, he says—"The

amount advanced to parties who were partners was £988,487. I should not like to infer from these figures that the money was wholly advanced to these parties, simply because they happened to be partners of the bank, but at the same time I have no doubt that that had a certain weight in inducing the management of the bank to make these advances, and it struck me that it was a thing the committee ought to know."

These extracts bring out the kind of transactions by which banking capital is rendered really to a large extent *fictitious*.

They well deserve the notice of all who are interested in the soundness of our banking system.

There are three ways in which the capital of a bank may be injured.

First, By the directors holding a large portion of it in their own hands. It never has existence in this case at all, it is never issued. Of the million which figures in the prospectus, not a half or fourth is really taken up.

Second, By the directors buying and selling their own stock, trading with it. And,

Third, By making advances on the security of the stock.

The balance sheets of the Western are now published, and we will draw our illustrations of how the security of bank stock is thus vitiated from the records of that bank.

The Western started in 1832, and professed to aim at a capital of £1,000,000.

But the stock accounts of these years tell a different tale. Three years after starting, in 1835, the capital paid up was only £283,720, and taking the subscribed capital at £1,500,000, the sum it was afterwards fixed at, there remained then in the directors' hands, £1,216,280!

In 1838 there had been issued £530,700, retained £969,300.

1843	"	£900,050,	"	£599,950.
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In 1846 they had over-issued, for now their capital stands at £1,672,400.—Why the directors retained such a large proportion of their stock we can only guess, probably they could not help it. They could get no more subscribed for at the time.

Glasgow is the commercial centre of Scotland, and its inhabitants have always ample employment for their own capital, and for all they can borrow from less enterprising neighbours. It was very unlikely that a fourth part of £4,000,000 could be found in the west so disengaged as to be at the service of the new bank when it started in Glasgow in 1832. Further evidence of this will appear afterwards.

But whatever was the cause, it is hardly fair to hold out that the capital is £4,000,000, when only £209,000, the amount in 1833, is really paid.

"Really paid,"—did we say, the calls may be really paid, and yet by other transactions really cancelled and annulled. The shares may be bought back by the bank, for, besides "the capital" account, there is another account in the Western's balance sheets, called "Company's Stock," which shows the amount of that capital which has been bought back by the bank. Why it had been resumed is not evident, perhaps it was forfeited by some bankrupt debtor, perhaps bought to maintain the price of the shares in a falling market, but whatever was the cause, if we wish to ascertain the real capital of the bank, the sum standing as paid by the bank in this account must be deducted from the amount of "capital" paid by the shareholders.

Perhaps, however, such deductions from capital are trifling, and the shares thus cancelled were few? The account tells not the number of shares, but the sum at the debit of company stock in 1836, stands £44,286.

" 1846,	"	65,790.
" 1849,	"	180,952.
" 1852,	"	367,529.

Thus more than *one-fifth* part of the whole capital seems to have been bought back in 1852, and of course the shares virtually cancelled, and the additional responsibility of 20 per cent. laid on the remaining shareholders.

The last mentioned plan of reducing banking capital must still be noticed, that of lending on the security of their shares.

The first advertisement of the new bank in 1833, throws light on this mode of procedure.

"The want of sufficient Bank Accommodation on Liberal Principles having been seriously felt and long complained of in Glasgow, it has been resolved to establish a

NEW PUBLIC BANK,

With a Capital of £4,000,000, divided into Shares 20,000, of £200 each.

First instalment not to exceed 15 per cent. or £30 per Share. Subscribers to be allowed to operate on their Shares to the extent of one-half of their advanced Stock—on the principles of a cash credit—and to such further extent as the circumstances of the Bank and the value of the Stock may warrant."

This means, "subscribe for £1000 worth of our shares, and we will return you £500, and something further if we can! It is rather ominous too, that in the first announcement of the Bank the only "Liberal principle" of banking distinctly announced, is, that one-half or more of the subscribed capital may be annihilated by being returned without any further security for its replacement to the shareholder! for such is really the import of such a clause. It is not known how far the original subscribers, whose shares amounted to £209,170 when the Bank had completed its first year, took advantage of so liberal an offer, but it is well worth notice that they had the power to reduce this £209,000 to £104,500 or such smaller sum "as the circumstances of the Bank might warrant." We know how vigorously this power was exercised subsequently, for in 1857, to the holders of 7626 shares or £381,300 of stock, there had been advanced £988,487, or nearly a million. The worth of that stock as *security* is well known; the amount lost of that £988,487, we do not know. That clause, "to such further extent as the circumstances of the Bank and the value of the Stock may warrant," seems to have been fully acted on, for those shares at £50 each, only represent £381,300, and the advance of one-half ought to be £190,650, instead of £988,487!

Having thus enumerated three modes by which the capital of a bank may be injuriously affected, let any one suppose all these agencies at work in one establishment, and estimating their power, say what security to shareholders or creditors

the capital of such a bank gives? In the case of the Western—first only £209,000 is subscribed out of £4,000,000—next deduct what has been bought back; even the first year the Bank has got £3550 thrown on its hand, and lastly deduct the sum, it may be one half of the whole capital, drawn out by the Shareholders in the Cash Accounts on the security of their Stock, and some estimate may be formed of what was the real amount of capital of this

NEW PUBLIC BANK.

Ought these things to be? Is there any use in a bank possessing a capital at all? Is capital necessary to banking? If it is, surely there is some ground of complaint in such a case as we have laid before us.

The paid up capital of a bank is announced, when it commences business, at £4,000,000; for three years afterwards it is, at its highest estimate, only about *one-sixteenth* of that sum, or £250,000, ten years afterwards it has only reached £854,000. At length in 1853, twenty years afterwards, the directors having been tempted by a premium, it may be supposed, over-issued shares to the amount of nearly £300,000, and having been obliged to buy back about an equal value, announce in their annual report, "It has been deemed right and expedient to write off these repurchased shares from 'stock,' and adjust the capital account which now stands at £150,000," representing 30,000 shares at £50 each, held by the public.

Such returns of the amount of capital are false. They deceive the public. When the amount of capital is stated in the advertisements of the company, it surely means that the shareholders have invested that sum in the business, and the amount is looked to as the stake they have in the undertaking, and a measure of their confidence in its success, besides forming a tangible fund to meet any losses, and to afford security to those who may deposit money in the coffers of the Bank. All we contend for is, that there ought to be nothing but the truth told. This seems reasonable. It has been decreed that coffee and chicory should henceforth bear each its own name, we cherish the hope that, at some future period, "capital" and "no capital" will be distinguished also.

Is it no injury to the public to place up such an announcement as this?—

"Western Bank of Scotland—Capital, £4,000,000"

—when really, according to the books of the Bank, the amount of stock paid up was for three years after its commencement only about £283,000, if not reduced to half that sum? The object of a capital is to give security to the depositors against loss—this is the primary use of a capital, and is it an improbable supposition that they who headed the advertisement of this new Bank, with the magnificent sum of £4,000,000 were really baiting a trap to catch deposits, and thus make further capital unnecessary. If this was not their intention, such would be the natural effect of their act. The principle is clearly stated in the Directors' Report for 1853: "The Directors embrace this opportunity of announcing, that it is not their intention to increase the Capital (of £1,500,000) by the issue of any new shares—inasmuch as the large and gradual augmentation of 'deposits' gives ample assurance of the power and efficiency of the Bank being fully maintained." "Power and efficiency" to *lend*, of course. Undoubtedly the plan succeeded; the Western Bank had five millions of deposits when it closed its doors.

Would it ever have had such a sum at its command with its advertisement altered thus—

"Western Bank of Scotland—Paid-up Capital, £250,000."

We think not.

It is evident that the Directors of any Bank being permitted to buy, sell, or retain such quantity of the Capital Stock of the Bank, renders the professed amount of subscribed capital utterly useless as a security.

As another mode of producing the same result, the whole plan of making advances on the Security of the Stock is decidedly objectionable. We know it is very common: almost every Bank in its constitution has power given to its Managers to make such advances to about one-half the amount of Stock to its Shareholders, but evidently it is just a mode of annulling and cancelling Stock to the amount of the ad-

vince given. Besides, such security is otherwise objectionable. It is well enough in prosperity, but if the Bank's affairs retrograde and the value of the Shares sink to less than half their value, or if the whole Capital be lost, then the concern is only burdened with just so much uncovered debt. Such a case as the latter is no mere supposition. Of what value as a security were the Shares of the Edinburgh and Glasgow, Western, or Royal British Banks? Of course such a result affects the interest of both the public and shareholders. They get for their security an unsecured debt instead of capital stock.

Let us now consider how such powers in the hands of directors specially affect the interests of the shareholders.

They inevitably lead the directors to speculation. Look at the history of the Western as traceable through its accounts. In the report of 1853, we are told "that the sinking fund has been chiefly created and augmented by premium on shares issued when the capital was increasing." The Directors had plenty of Stock to dispose of, when out of £4,000,000 only £200,000, or a twentieth part was issued.

Did they improve their opportunity? The state of the "sinking fund," and how it rose, will best tell. The first eleven years of the bank's existence, the dividend never being more than 6 per cent., the premium at which the stock was issued by the directors must have been small, and the sinking fund though gradually increasing to about £50,000 shows no great or rapid growth, but in 1845 the capital grows some £300,000, and the sinking fund gains in that year, £120,000. This good fortune encourages the prosecution of this line of business, and next year £370,000 of stock is issued, and £170,000 is added to the fund. The year 1847 shows only £100,000 additional capital, and £40,000 profit.

This gain depended on the market price of the stock, and that being affected by the rate of dividend, it is natural to find the dividend rising in 1846 to 7, and in 1847 to 8 per cent. An additional per centage brought a good return in the share market. The only thing which seems to have put an end to issuing new stock after 1853, was the difficulty of paying a dividend on a larger capital than £1,500,000. Of course this did not prevent them from buying and selling the

old stock; it did not prevent them from holding a good many shares in 1857.

In two modes then are the shareholders affected by these dealings.

First. They never know with any certainty the real value of their shares. The temptation to raise the dividend is so strong when the bank itself can so easily repay itself by the premium on the rising shares, that it cannot be resisted. All is done for the interest of the shareholders. The premium goes to their account, but still they cannot feel secure, that the augmented dividend is not just a mode of raising the market price of the stock. The directors are continually exposed to devote their first attention to make the bank stand high in the share list, instead of seeking to make it *deserve* to stand in such a place.

And then, when rumour breathes unfavourably on the stock, or deserved suspicions haunt the public mind, the directors are driven to the desperate remedy of heightening their dividend. It cannot be helped, "The stock is sinking in the market, shareholders will sell out, depositors will withdraw their money, we must put on another per centage on the dividend!" So in the bank whose history we are tracing. In 1856, a year before it stopped, up the dividend went from 8 to 9 per cent!

This is quite conformable to the rule and practice of all who are hemmed in and oppressed by adverse circumstances, yet dare not economize or dispense with a single outward token of prosperity, lest the number and the pressure of their creditors should be augmented four-fold.

Second. Shareholders under such a system can never know the amount of liability under which they come. This is obvious. The larger number of shares the directors buy up, they are really increasing the responsibility of the remaining shareholders. Thus the Western Bank Proprietors found that they had to divide the liabilities of some 2500 shares among themselves, as these shares were not held by any responsible party, and those liabilities amounted to £300,000, a loss the heavily burdened shareholders were ill able to sustain.

In this case there were not more than one-tenth of the shares held by the Bank, but what is worthy of note is, that

there seems no limit to the amount directors may buy up, and no limit to the amount of additional risk that may thus be imposed on the shareholders. No one can know how many of his co-proprietors have thus been set free from all share in the undertaking, or how few are left to share with him the unlimited liability of the Joint Stock Company.

It may be said that as in almost every bank, the shareholders have unlimited liability, it matters little whether they have many or few to share the responsibility with them. Certainly if the shareholders are all to be reduced to bankruptcy, additional responsibility is of little consequence to the bankrupt, but such is an extreme case. Frequently a large copartnery might so lessen the loss, as to save all the holders from such ruin. All banks have not unlimited liability, and there the power of the managers to purchase stock for the bank tells most injuriously on the security to the creditors. Parties may dispose of their shares to the company, and just by so much annihilate the fund to which alone the claimants on the estate can look for payment. But where there is unlimited liability, it acts most injuriously. The fewer partners the less falls on, the heavier will be their share, and to take a portion of the sadly reduced funds of a ruined establishment, and return to some shareholder the whole or part of his stock is a flagrant piece of injustice. The shareholders who remain, not only bear the share of loss which the outgoing partner ought to bear, but they have to pay out of their scanty resources for this privilege conferred on him and for his escape.

Bank Stock will never be sound and trustworthy till banks are in some degree restrained from *buying, selling, and retaining* any portion of their capital, and also from making *advances on such security*.

We would be thankful, meanwhile, did Government, when it makes the Joint Stock Banks annually publish the list of their shareholders, make it imperative also to publish the aggregate sum of stock as in the hands of these parties.

No reference has been made to the temptation to private speculation, to which such a system exposes those connected with the management of a bank. The temptation is not slight.

SHAREHOLDERS.

The great sufferers in the bankruptcy of the Western Bank, were the shareholders. The Note-holders and the Depositors lost nothing, and though some of these creditors may have suffered considerable anxiety and inconvenience, the whole ultimate loss fell on the partners.

There are some features of its history instructive to shareholders in banks generally.

In Scotland, for a long time, "bank stock" has been popularly considered equal in safety and superior in its return to "consols." The events of the last ten years have done much to show the fallacy of such an opinion. One bank of a million and a half of capital has lost that sum twice told; another bank with a million for its capital has quietly lost it all. Both the banks had a copartnery of from 1200 to 1800 partners.

These shareholders now understand, and it would be well for all bank shareholders to understand that *Banking is a trade*, and like every other trade incurs risk. It is not, and ought not to be viewed as affording a safe and profitable investment for those who, ignorant of business, wish to invest their little capital, so as to afford a means of livelihood.

It is sad to know that so many persons of that description lost their all in these recent failures.

The courts of law it is understood, enforce this principle, by holding trustees, who without powers expressly authorizing it, risk the funds of the trust in banking, as personally liable for any loss incurred in such trading.

If such is the true character of banking, if it is a trade, it seems evident none ought to be bank shareholders who are utterly ignorant of business. If any one advises such an investment, or invests money in bank stock for ladies, widows, or any other parties incompetent to understand the nature of such an investment, we think such an agent is bound to watch over the interests he has risked while the danger lasts.

If it is being over cautious to condemn as imprudent the conduct of so many whose names are still on the list of share-

holders of our Joint Stock Banks, surely it is not over cautious to say, that no one ought to invest thus his whole, or even the half of his means of livelihood. It may not be so objectionable, if any one has a few spare hundreds, which must be invested some way, to place the money in bank stock where a little higher interest is to be had, and something additional may be gained by the increased value of the shares if the concern prospers, and where if it does not prosper, no loss can seriously affect the condition of the shareholder; but for trustees to invest the whole little fortune of orphan children, or risk the life-rent interest of some widow or lonely lady, even in so secure a trade as banking was once thought to be, is most unjustifiable.

If such parties ought not to hold bank stock, who ought to hold it? some may ask. The answer seems obvious. Those who are acquainted with trade and the management of pecuniary affairs. We are strongly in favour of the Joint Stock principle in Banking. We would like all who have business with banks, and who have the competent knowledge and capital, to have a share and an interest in these companies, so that really the whole nation might be security for the stability of the system.

The next point that stands out to the observation of those interested as shareholders in a bank, is that the clause generally inserted in the constitution of such copartnerships, "that on there appearing at any balance of the Company's books a loss amounting to 25 per cent. of the original capital, (or such proportion as may be deemed suitable,) the Company shall *ipso facto* be dissolved," is practically useless.

It was intended in cases where the liability was unlimited, to secure that the loss never should exceed a certain proportion of the original stock, but it has utterly failed to afford such protection. The Western Bank had such a provision in its contract, that if on balancing the books such a loss "*appeared*," the result should be immediate dissolution. But such a loss never *appeared*; that was carefully avoided, even when the capital was hopelessly squandered; even a few months before the final catastrophe.

A little "jugglery of figures" was all that was required to hide the truth, and in such circumstances it is to be feared

such modes of concealment will be so often practised, that shareholders must look to other quarters for some security against ruin.

It were well perhaps at once to state our conviction, that the quarter where such security can be found is quite opposite in its nature from a formal check, such as the clause of the contract just noticed. If paper, parchment, stamps, and ink could secure honest and efficient management, it had been universally obtained long ere this. It is not by any formal checks or rules that the prosperity of an undertaking is secured. Shareholders can only secure the prosperity of their bank as they do that of their own individual business, by giving attention to it.

This is really the sum and essence of the duty of partners towards their companies, that they ought to take more interest in and pay more attention to them. Banks cannot manage themselves, and as our men of business well know no paid service is an efficient substitute for the "master's eye." Our Shareholders, not the Directors or the Manager, are the real masters. This duty has been much neglected; the only inquiries most of the holders of our joint-stock banks ever make, or think of making, are, what is the amount of dividend and when is it payable. They do attend to this, but beyond this they give little attention, and take little interest in the affairs of their Bank.

Does not such neglect reap its natural reward, when those who would not pay attention to the company's affairs, so as to keep them right, are called on to pay a call of so much per share to liquidate its debts?

It may be asked, "what good can so general and indefinite a thing as the interest or attention of 500 or 600 men effect on the affairs of a commercial concern?" We know that to be effective it must not be indefinite or general, it must be defined and practical, and we will suggest how it may in some degree be made so. Yet we plead that each shareholder should give attention and take an interest in the prosperity of his company, though we could not show any definite form such attention and interest might assume. If the mind is really turned in that direction, it will find some mode of practically reaching the result. Attention is a most effi-

cient and practical thing in a person's private affairs, and it will be so too in a joint-stock Bank.

Still one or two hints may be offered regarding what shareholders may do. First, they may exercise their judgment and power in choosing the directors and the office-bearers of the bank. To put the right man into the right place is an important and difficult duty. It is one on which the prosperity of large companies must ever directly depend. It generally devolves on the shareholders. Sometimes only the directors are chosen by the company, and the appointment of the office-bearers is left to them. Though, of course, the opinion of those best qualified to judge ought ever to have due weight, still, perhaps, it is the best working arrangement to make the Manager's place at least independent of the pleasure of the directors. This is done in some societies.

Then the selection of gentlemen to take part in the direction ought not to be done at random. These men are the substitutes in a great measure for their constituents, and those ought to be chosen who can and will give time and attention to the business. There ought not to be too many, that divides the responsibility too much, and such a number of competent men may be difficult to get. Neither ought there to be too few, for then the work is too heavy, and it is formally or slightly done. It is too much to hope that there will be none at the board who are merely nominally directors, but undoubtedly there ought to be as few as possible.

The fact of two or three bank directors being condemned to confinement in prison for a six or twelve months, and a much larger number of such gentlemen having to stand as defenders in dozens of law-pleas raised by the enraged and suffering shareholders of the companies they acted for, places the responsibilities of the Directorship of Banks in an impressive light, and makes it much to be desired that instead of instituting legal proceedings against these men after the mismanagement has taken place, some care were taken to make a proper selection, and thus prevent the disaster altogether.

Next, Shareholders might attend the meetings of the Proprietary of the Bank. They take place not oftener than

twice a year, and ought to be more than a formality. The meetings are generally nothing else, but they are just what the proprietors make them. They may come and freely speak their thoughts, and deliberately, calmly do their duty, or they may stay away, and out of some thousand partners a score or two may appear only to enable the Directors to go through the usual formalities decently. The others come on dividend day only. Generally the attendance at the annual meetings is very miserable. The work consists of choosing the Directors and submitting the state of the Bank's affairs at last balance. Might it not secure a much larger attendance, if the warrants for an instalment of the year's profits were issued at the place and made payable on the day of the annual meeting?

Lastly, Bank proprietors ought to insist on knowing more and more accurately the affairs of their company.

Ask one of the proprietors of a Bank, perhaps one of the old and best Establishments, to go to the annual meeting, and probably he will reply, "Why should I go? they will read over long lists of figures, so many millions hundreds of thousands, and actually tell you the odd shillings and pence that have been made last year, but you will not understand or remember one jot of it, nor will you be a bit wiser." The objection is founded on truth, the annual statement of the profit and loss is very interesting, but it must be seen not heard if it is to be understood. No one can carry in the mind columns of figures, especially if they are just once read over to him, yet that is all that most of our Scotch Banks do. There ought to be a plain full vidimus of the position of the company's affairs printed and sent to each name on the share list of the Bank. It is quite true that will not secure prosperity nor even truth. The Banks in Scotland in most undoubted credit never do such a thing, but neither have they prospered because they did not do so, and as such information seems to be the right of the shareholders they ought to get it. Either the balance sheet ought never to be submitted or it ought really to be done, and not merely read over to a mere handful of those interested in it. There is no other way this can be submitted to all except by printing it.

It is of some importance in what form the statement of the

Bank's affairs ought to appear, and how much of the detail ought to be shown.

Evidently the statement ought to be thrown into the simplest form; all professional accountant-like language ought to be as far as possible avoided. Perhaps it cannot be made intelligible to all, but it ought to be unintelligible to very few.

It ought to be signed by the Manager and by the Accountant specially as a true balance of the books of the Bank. Besides the Directors or Auditors, the individuals who personally have examined the accounts and signed the docket vouching for the accuracy of what they have examined, ought to append their docket and names to the statement.

The object to be attained by these measures is to fix personal responsibility.

Without proposing any form into which the accounts might be generally thrown, some points ought to be brought distinctly out:

The amount of Bullion held.

- " of Government Securities.
- " of Over-due Bills.
- " of Bills bought.
- " of Bad Debts.
- " of Debts in Suspense.
- " of Heritable Property.

On the other side of the account there ought to appear:

The amount of Deposits.

- " of Deposits at call.
- " of Note Circulation.
- " of other Obligations for which the Bank is responsible.
- " of Undivided Profits or Rest.
- " of Divisible Profit.

Besides these, there are, as has been noticed elsewhere, certain channels through which the property of a Bank is peculiarly apt to be lost, and it would be well if a definite answer could be given on such points as these.

What amount of debt has been outstanding longer than two years?

What amount of assets could not be realised within six or twelve months?

What are the number and amount of the debts due to the Bank, which taken singly are above £5000 or £10,000.

Has the Bank any pecuniary responsibilities besides those noticed in the balance-sheet? (*e. g.*, "rediscounted bills," "acceptances.")

There is still the question regarding auditors to dispose of. Ought the proprietors to appoint auditors themselves independent of the directors and office-bearers? There ought to be auditors undoubtedly; they ought to be known and satisfactorily to the shareholders, but except in special cases or at fixed periods, say every five years, it does not seem expedient to have appointments of that nature.

One obstacle may seriously impede the attainment of this knowledge on the part of the Shareholders, and that is the idea that such open, frank dealing will injure the Bank's credit. Most willingly do we admit that there are limits beyond which public inquiry must not come; yet generally such a plea ought not to be listened to readily by the Shareholders. If a Bank must for its credit withhold the real state of its affairs from its own Shareholders, that is the strongest reason why they ought not to permit it to be withheld.

Such secrecy may be advantageous to keep up the stock in the market, and allow some director or individual shareholder to sell out, but it almost never can be advantageous to the proprietary at large. If there is anything wrong, they have a right to know it; if there is nothing wrong, and the credit of the company is deserved, the knowledge of that cannot injure its prosperity.

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SECRET MANAGEMENT.

Though this is an age when Joint Stock Companies professedly do much, every one knows that there always are some one, two, or three individuals whose thoughts and energies really set the company in motion, and decide what direction that motion shall take—perhaps oftenest the whole depends on one man. One mind plans and commands the whole affair, and the grand sounding name of the Company, is only a “cloak of darkness” to conceal from the public “the manager.”

It is well known, too, how the management of one excels that of many, or of more than one. In completeness of plan, in decision, in energy, in speedy execution, all the advantage is on the side of the single managing power.

In Banks it is ever the same. The character of the establishment, its progress, its maintenance or its loss of its position, depends on the gentleman who is at its head. Frequently that individual is not nominally “manager,” he may be “secretary,” or “cashier.” Still his character is all-important to the institution, and its success is mainly dependant on him. How often the expression is heard, “such a one made the Bank.” We need not give examples of the advantages of such management, but unfortunately we have recently had too many examples forced on our attention of the disadvantages of such management when combined with *excessive secrecy*.

It is not the fact that Mr Smith and then Mr Taylor were “the managers” of the Western Bank, and lost a sum equal to its capital twice told, or that Mr Richardson was “manager” of the Northumberland and Durham District Bank, and Mr H. I. Cameron of The Royal British Bank, to the utter ruin of all concerned, but the fact that claims the most serious attention is, that no man among the directors or office-bearers of these great companies, except these “managers,” knew in the least the real position of their affairs. It is this excessive secrecy we complain of; and the question arises, can we not secure all the advantages which flow from placing the control of the whole under one mind, without the disadvantages which flow from such excessive secrecy?

It is impossible to believe that the Banks now referred to could have come to so disastrous an issue, if the knowledge of the real state of their finances had not been locked up for years, within the breast of a single individual, and kept secret from all the other office-bearers who nominally shared in the responsibility. Mr Fleming in his evidence states that from documents in the handwriting of Mr Taylor, late manager of the Western Bank, he is convinced that many years before the final catastrophe, Mr T. knew that bad debts had been incurred to the amount of more than one quarter of a million, which nevertheless he represented in the balance sheet to the directors and shareholders as good, and further, that the manager got that information from the clerk who kept the records of these debts, and who, under proper authority, would have exhibited the same statement to any director or auditor, and thus effectually have prevented such an imposition being practised by any individual.

The same gentleman in his evidence declares, that the secretary, cashier, and accountant of that establishment, had not, he believes, any idea of how deep was the ruin that impended over it. So exclusive was the power of the manager, that he was the only person in the Bank who could authorise a £100 bill to be discounted.

The directors had no details of the transactions of the company laid before them, from which any such discrepancy as really existed for many years could be discovered.

The previous manager of the Western, Mr Donald Smith, acted on the same system of concealment.

The Northumberland and Durham District Bank was conducted on the same close system. There, more than the whole capital was advanced to an Iron Company, in which Mr Richardson the manager was deeply interested. Of course the secret was well kept—so well that the credit of the Bank was sustained amid difficulties and losses in a most surprising degree, till almost the very day it stopped payment.

As for the general manager of the Royal British Bank, he not only kept the secrets of the Bank locked up in his breast, but he kept there the key of a safe where a *private ledger* was hidden, into which he entered all transactions he meant for no eye but his own. The nature of these transactions, the

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In Banks it is ever the same. The character of the establishment, its progress, its maintenance or its loss of its position, depends on the gentleman who is at its head. Frequently that individual is not nominally “manager,” he may be “secretary,” or “cashier.” Still his character is all-important to the institution, and its success is mainly dependant on him. How often the expression is heard, “such a one made the Bank.” We need not give examples of the advantages of such management, but unfortunately we have recently had too many examples forced on our attention of the disadvantages of such management when combined with *excessive secrecy*.

It is not the fact that Mr Smith and then Mr Taylor were “the managers” of the Western Bank, and lost a sum equal to its capital twice told, or that Mr Richardson was “manager” of the Northumberland and Durham District Bank, and Mr H. I. Cameron of The Royal British Bank, to the utter ruin of all concerned, but the fact that claims the most serious attention is, that no man among the directors or office-bearers of these great companies, except these “managers,” knew in the least the real position of their affairs. It is this excessive secrecy we complain of; and the question arises, can we not secure all the advantages which flow from placing the control of the whole under one mind, without the disadvantages which flow from such excessive secrecy?

It is impossible to believe that the Banks now referred to could have come to so disastrous an issue, if the knowledge of the real state of their finances had not been locked up for years, within the breast of a single individual, and kept secret from all the other office-bearers who nominally shared in the responsibility. Mr Fleming in his evidence states that from documents in the handwriting of Mr Taylor, late manager of the Western Bank, he is convinced that many years before the final catastrophe, Mr T. knew that bad debts had been incurred to the amount of more than one quarter of a million, which nevertheless he represented in the balance sheet to the directors and shareholders as good, and further, that the manager got that information from the clerk who kept the records of these debts, and who, under proper authority, would have exhibited the same statement to any director or auditor, and thus effectually have prevented such an imposition being practised by any individual.

The same gentleman in his evidence declares, that the secretary, cashier, and accountant of that establishment, had not, he believes, any idea of how deep was the ruin that impended over it. So exclusive was the power of the manager, that he was the only person in the Bank who could authorise a £100 bill to be discounted.

The directors had no details of the transactions of the company laid before them, from which any such discrepancy as really existed for many years could be discovered.

The previous manager of the Western, Mr Donald Smith, acted on the same system of concealment.

The Northumberland and Durham District Bank was conducted on the same close system. There, more than the whole capital was advanced to an Iron Company, in which Mr Richardson the manager was deeply interested. Of course the secret was well kept—so well that the credit of the Bank was sustained amid difficulties and losses in a most surprising degree, till almost the very day it stopped payment.

As for the general manager of the Royal British Bank, he not only kept the secrets of the Bank locked up in his breast, but he kept there the key of a safe where a *private ledger* was hidden, into which he entered all transactions he meant for no eye but his own. The nature of these transactions, the

Judicial and Criminal Courts of England now know, and both the shareholders and depositors know the result of such secret management.

These facts seem to form a ground amply sufficient for the directors and shareholders instituting the inquiry. Is it necessary? Is it expedient that one man alone should know the real state of our affairs? Subsequently the question how can this be remedied, may be considered.

Such secrecy is never pretended to be necessary. For professedly every balance sheet submitted by the manager to the directors or shareholders, is an acknowledgment of their right to that knowledge which is often practically withheld. Besides, it is the knowledge of the detailed transactions of the trade customers of the Bank, that it is so essential to keep private, and that is the object of such jealousy and care. Commercial men dread their rivals in business becoming acquainted with their customers or the nature of their transactions, but the public have no objection to the greatest publicity as to the balance sheets of their banker. It tells nothing about them or theirs.

The point at issue however is not whether the public ought to know the state of these Joint Stock Banks, but a much narrower one—"ought no one to know it but one man." Ought hundreds of shareholders who frequently risk their whole property, directors chosen to represent these proprietors and paid officials, all resign any right to question or investigate the statement of the affairs of the company, and entrust the whole to the ability and honesty of one man "our Manager."

This seems objectionable, for it invests one man with too much power.

Ambition has found its gratification in the possession of money—for money is power. It has been told that one of the great money lenders of Europe, when rumours of impending war reached him on the Exchange, he quietly listened, and buttoning up his pocket, said emphatically—"There shall be no war." There was a money power affecting the state of Europe.

One of the ex-managers of a Joint Stock Bank used to boast that he "wielded a ten million power!"

The danger lies in this, that the ambition to figure as the

controller of such a capital leads men to act under a motive very different from that which ought to regulate their management, and acting from a different motive leads to different results. It is not possible to explain the mismanagement of some of our Banks on any other principle. There was no want of ability or of attention, no advancement of private interests at the expense of those of the company. It really seems that it was an inordinate desire "to do a large business" that led to bankruptcy.

Such secrecy is injurious to the company alike in prosperity and adversity.

If the company is prosperous, such concealment is worse than unnecessary, for it enables jealousy to hang doubt and suspicion round facts capable of being most fully vouched. The more prosperous a concern is, the more injurious such a course is, for it is on such occasions that suspicions are most rife. If a company can pay a larger dividend than their neighbours, they ought specially at such a time to make without ostentation, a thorough satisfactory investigation of all their manager's accounts.

If things are retrograding, such secrecy is most disastrous. Bad debts are accumulating, but the manager only knows their amount, then the old temptation comes over him. "Why tell this? It only makes things worse; by not telling it, after a few better years, all traces of it will disappear? Besides, no one can be sure that these are really irrecoverable debts—'why may they not stand over in suspense' till another balance? Then if it was all known there would be such talking about my management?" Such a pressure of thoughts can easily be foreseen as likely to haunt the mind of a responsible manager in disastrous times. The result, as nine bankrupts out of every ten can testify is, that hope deceives, and ruin deepens. Things do not get better: they get worse, and then the arguments for concealment strengthen, and the principle of the propriety of such a course has been already practically admitted, it is adopted again, and quietly nothing is said. The account of "outstanding debts" is still "in suspense," "they may be partly irrecoverable, but it is impossible at present to decide to what extent."

It is not proper to expose any man to the temptations of

such a situation. The manager who knew that his accounts were regularly audited would be freed from them. The painful doubts and discussions in his own mind would be at once dispelled—no fallacious hopes would deceive and lead to deeper ruin.

This view of the case suggests how much those who are managers ought to desire and court a full investigation of their work. Such a thing would strengthen their position and add to their influence. All that we plead for is not a surrender of any part of their power, but only a full exposition to another party of how it has been used. What we wish destroyed is that system of concealment whereby the manager is the only one who is thoroughly cognisant of the bank's affairs. When the weather is calm and all right on board a ship, it is quite sufficient that the captain has made his observations, calculated and knows the position of his vessel on the surface of the ocean, but surely it is most unwise that in a long voyage with many lives and a precious cargo under his care, the captain should be the only one on board who has the ability and materials necessary to ensure safety, or bring the voyage to a prosperous issue. Is it not as unwise to leave the whole affairs of an extensive commercial company in the exclusive knowledge of one man?

But many may at once admit the impropriety of such excessive secrecy, and yet under the idea that it is inseparable from the advantages accruing from having one able efficient man at the helm, be disposed to let the system continue as an evil for which a practical remedy cannot be found.

It does not seem really to be an evil of such a nature. Let it once be distinctly decided that such a thing is unwise and disadvantageous, and a remedy will be found for it.

The magnitude and multiplicity of the transactions of a bank would, it is supposed, effectually prevent a thorough audit of its accounts. Let this be considered. The Western Bank had 101 branches, besides the extensive business carried on at Glasgow. Now does any one suppose that Mr Taylor had a personal knowledge of the responsibility of all the debtors who borrowed the Bank's money throughout Scotland? or that even in Glasgow he knew the amount of credit, and the worth of the security given to the Bank for every

advance it afforded? Such is not the system. The manager acquired a monopoly of the knowledge of the affairs of the Bank, because he was seated in the centre of all the lines of intelligence which continually conveyed to him accurate intelligence of all that occurred throughout the wide circumference of the Company's trade. Two or three Inspectors received, digested, superintended, and reported all that went on at these 101 Branches. The Accountants at Head Office spread before the Manager the balances of their accounts with bankers and correspondents; the amount of discounts to each house, the state of their advances and the securities; the position of the London Account; the Bills for Discount, and the state of outlying debts.

It is by a careful subdivision of the extricate and wide spread business of a bank under various competent subordinate management that the threads of the whole can be held by a single hand. Now this very subdivision makes inspection easy. The manager has simply to let those who are appointed to inspect his establishment enjoy for a short time the aids and advantages he has ever at his side, and standing there in the centre of light, it would not be difficult to scan all he sees, and judge if he has accurately depicted it.

Who ought thus to audit the manager's management? If there is truth in the foregoing representation, if this aid is to be found ever ready in the subordinates of the establishment, then the amount of time and labour requisite is not so formidable as to prevent some of the Ordinary Directors of the Bank from undertaking it annually. Let them subdivide the work, examine and certify the state of some particular department consigned to each, and the whole would be soon completed.

The other mode is to employ periodically, as our Insurance Companies do, an auditor accustomed to such work, though not interested in the Company, and giving him the same aids, receive his report. But some way or other, surely a remedy ought to be found to prevent the evils flowing from excessive secrecy.

DEPOSITORS AND LIMITED LIABILITY.

On glancing over the events of 1857, two facts seem worthy of the attention of those who lend their money to banks, the Depositors. These facts are important, because they illustrate important principles.

1. Both the Scottish Banks which stopped payment that year gave a half per cent. extra to their depositors. They did not always do so, but frequently, very frequently, the other banks were told by their customers, "I can get more interest elsewhere, pay me my receipt," and the deposit was removed to the Western or the City of Glasgow Bank.

Such liberality does not usually arise in bankers from benevolent generosity, but from the fact that they are in want of money. Therefore they offer higher terms than the current rate. They must have the money and will give any terms to secure it. Such is always the position of needy borrowers. Our gay young officers, who are unfortunately obliged to apply to some "Merchant of Venice," never drive a close bargain as to the rate of discount, they will allow any per centage to get the hard cash down.

An experienced commercial traveller hearing of an extensive order given at once, without much regard to price, by a party he did not know, advised delay in executing it, for, "said he," it looks as if he never "*intended to pay!*" It was quite true, when a man intends to fulfil his promise he is slow to promise, and often drives a hard bargain, but the merchant or the banker whose first object is to get the goods or the capital into his hands, and with whom paying for it is quite a secondary consideration, will offer any conditions.

If unusually high interest is offered for money, it would be well to consider whether the party borrowing has any intention of repaying the capital.

The principle this fact illustrates is just the common place remark, that a higher than the current rate of interest represents greater risk. The Depositor gets more interest but less security. It is unnecessary to say more on such a point.

2. The other fact is, that the Shareholders of the Western Bank had *unlimited liability*.

Its Shareholders know that to their cost, but it was well for its Depositors that it was so. We sympathise with the suffering shareholders, but it is cause of gratitude that the Depositors have not lost a shilling. Had the loss fallen upon them, the amount of suffering would have been far greater.

The value of the Deposits of the Western Bank was £5,300,000, and the number of their Depositors was 42,000, and of those, 26,000 were under £50 each. Let any one who knows that class, calculate how many probably of these had placed in that Bank's hands the savings of a life-time of toil, the whole sustenance of old age, the provision for rearing an orphan family, or sustaining a widowed mother; and imagine how much suffering would have followed had the loss fallen on such a class, who are generally far poorer and far more numerous than the Shareholders.

These creditors of the Western Bank would have lost seriously had the liability of the Bank been limited. The Capital has been exhausted, and two calls, one of £25 and another of £1 per share have been made on the Shareholders and largely paid. The amount of the Capital has been nearly twice exhausted before the Depositors could get their own.

We would like the attention of our readers to the "*Limited Liability*" principle, especially as applied to Banks. The fact above stated ought to secure the attention of those who entrust their money to banks.

Within these three or four years, in consequence of sundry Acts of Parliament, almost every new Joint Stock Company that has started, has appeared before the public with the word "limited" attached to its title. Do the public fully realize the import of that little word? It signifies that that Company have secured, under Act "Victoria so and so," the inestimable privilege of unlimited profit but of limited loss. The Company register the names of their Shareholders and the amount of their Capital in the public office where they can be reached by any who choose to take the trouble, and in return for this, if they should be so unfortunate as to lose in their speculation more than their capital, the public has no recourse on these Shareholders, but must bear the loss themselves.

How did such an arrangement become law? We have some idea that it was the result of "class legislature," and of the influence of a class whose power the country ought to be jealous of,—“The aristocracy of wealth,”—the money power of the kingdom; a power never exercised for any noble, generous, or elevating end, ever grasping, selfish and mean.

The measure suited this class, “our capitalists,” a class of great influence; and it also suited another class, “our speculators,” a class of untiring activity. The first longed for unlimited profits, but would not risk their whole fortunes in any one enterprise. The second longed for capital, but could not get it under existing liabilities. The “*limited*” responsibility Act served both. A Joint Stock Company “*limited*” was established. The capitalists got their high profits and little risk, and the other got the capital to speculate with, to them the great necessary of life. Let us look at this arrangement, first in general, and then as applied to Banking.

1. Surely it is most proper that the risk of all undertakings should be on those who have the means of knowing, and the power to regulate the amount of that risk.

Now such knowledge and such power always lies with the shareholders and not with the public. But these Acts of Parliament really transfer it from those who know, or who may know the real state of the Company's affairs, to parties who cannot have any right, and probably have not any means to ascertain such facts.

Most of these Companies, it is to be hoped, keep some sort of books. They have annual meetings of their Shareholders, and a balance-sheet of some description is exhibited in a becoming preface for the announcement of the amount of dividend; now Shareholders have a right to see these books, and to examine or get examined the balance of their affairs, and may know somewhat of how their affairs really are, and thus may discover and control the amount of their responsibility, and therefore on them the liability should rest. None of these privileges belong to a creditor of the Company, and therefore beyond knowing the general character of those with whom he deals, he ought not to be liable for the management of the Company.

2. The “*limited*” responsibility tends to increase the probability of mismanagement.

Why, even with the unlimited liability of the Directors and Shareholders of the Western Bank, though each man knew that his whole fortune was at stake, there was not, during many years of flagrant mismanagement, motive enough to make any of the Directors ask a few simple questions or spend time sufficient to verify the balance of any of the most doubtful accounts, nor one out of so many hundred Shareholders demand an opportunity to satisfy himself that he was safe. And what does the introduction of this principle effect? One would have expected that with such evil existing the course pursued would have tended to make Directors and Shareholders more alive to their interest, and measures would have been devised to make these parties more strict and less negligent in looking after their affairs. Instead of this, Government steps kindly forward and says it is very hard that you should either be compelled to attend to your affairs or submit to the natural consequence of neglect, we will secure that in future you shall enjoy profit and your ease too, you shall be protected from all loss beyond a limited sum.

This is likely to produce some specimens of mismanagement far exceeding anything yet produced. It is dangerous to prophesy, but give these companies time to pay “*unlimited*” profits, handsome salaries to officials, and to expend their own capital and all they can borrow from others in reckless speculation; let another commercial crisis come on our country, and these limited concerns vanish like smoke, then the public will find that “*limited*” really signifies that they get the loss and others get the profit. Then there will be a general and bitter cry for repeal of such “acts” as these.

3. The most serious question remains to be considered is “*limited*” liability, *fair and equitable*.

Of course it is made law, but it may not be equity.

The law has made a condition universally binding in trading with these companies which no one would submit to in his ordinary transactions. The dealings are not with *individuals*, but with certain *defined amounts of property* said once to exist. Would any one sell to a man who said, “Now I had £100 in this pocket when I came to the market, and

you will get payment out of that pocket if there is enough, but you shall have no claim on what is in my other pockets?

Why should any one who will not take unlimited risk seek unlimited profit? Can a sufficient answer to this question be given? It is said it is hard that by taking a £10 share in a concern a man's whole estate should be made responsible, and perhaps the man ultimately ruined. The answer is very simple: let the Shareholder *limit* his profit, and his risk is *limited* too; let him lend the £10 at a fixed rate of interest and his liability is restricted at once; let him be a Lender and not a Shareholder and he has restricted liability—he is safe.

It serves to test the fairness of a principle to bring it out in an illustration. Many cannot judge of a principle who can feel distinctly the merits of any particular case.

Suppose a Bank with limited responsibility in fair credit, a Depositor lends the Bank £1000, perhaps the whole trust fund of some orphan family. The Establishment seems flourishing, the Manager is liberally paid, the Directors are most respectable men, the Dividend is rising, they divide 10 or 12 per cent., and seem extending their business far and wide. The interest on the Deposit is not above the current rate. The season of prosperity closes; interest rises, and a severe pressure begins to try the commerce of the country. Suddenly some extensive house stops; the Bank is a large creditor, a very large creditor; an alarm is given, confidence is shaken, difficulties thicken—crash after crash—and misfortunes are accumulating on the doomed Establishment—a few struggles and it shuts its doors.

The partners lose their capital; many of them have drawn 10 per cent. for 6 or 8 years, and they are all pretty safe. The Depositors' claims are twice or thrice the amount of capital, and after having their money locked up for months, annoyed with the uncertainty and the harassing details of legal proceedings, they get 10s. per £1. It was the Depositors' money that made the profit of 10 per cent. to the Shareholders. The Depositors' interest was a fixed low rate; they shared not in the property of the Bank. They had no right to ask, no means of knowing whether it was prosperous or not. But now they must bear most of the loss, while those who

reaped the benefits of the season of prosperity escape comparatively unscathed. Is such a thing fair?

Two other pleas might be urged why the Banking Institutions of our country ought not to be placed in so invidious a position. Our Banks, especially in Scotland, have been and are the great motives to industry and prudent accumulation. Anything, therefore, that affects the stability of our Banks will injure National Industry. Saving Banks are comparatively little required in Scotland; our banking system has ever held out every inducement to make the population careful and industrious. Small sums have been always received at the Head Offices and at the numerous Branches scattered over the country; held at call; and interest from day to day granted on them. The Western Bank alone had 26,000 Depositors under £50 each; some of the Banks in Scotland have nearly twice the amount of Deposits, and will have nearly twice as many Depositors. All this stimulus to industry depends on those who thus deposit their savings knowing that they have somewhere to place them where they will be perfectly secure—let anything cast a doubt over this security, and the temptation to spend their money is increased as the inducement to save it is diminished. True, the creditors of Banks have not yet suffered from the limited guarantee of the Shareholders, but if there is truth in what we have described as the natural working of the system, then the time will come when they will lose; confidence will be shaken; depositors will not have any such inducement to accumulate their savings, and national industry will be injured.

Again, our Scottish Banks and many English ones supply a large part of the circulation of the country. All who view the currency of an empire as a legitimate care of Government must hold that Government ought to make that currency when it is "paper" as secure as possible.

Is the Government making the circulation as secure as possible when it grants the Bank of England a restricted liability, and thus leaves twenty millions of the Bank's notes in the hands of the public without any security beyond what the other creditors of the Bank would have on the property of the Bank? Some have supposed that the holders of the notes have a prior claim to other creditors of the Bank. It

seems evident they have not; the opinion of Mr Freshfield in the Appendix to the Report seems quite satisfactory. The banking regulations of America might teach us the impropriety of such a state of things. In New York not only has security to be lodged with the Government for every note issued, but note-holders have a prior claim to every other creditor.

The circulation of our Scotch Banks is doubtless perfectly safe, while they offer unlimited security, but they ought *all* to give that guarantee to the country, especially when Government gives the note-holder no priority of claim.

After all some one may ask, "why so much argument against limited liability on Banks, when it is not proposed; they were expressly excepted from the other joint-stock companies in the recent Act? True, but many things seemed to show that that exception would be sought to be abolished; the strong bent of our influential money-lords, thus "to cut short their losses, but let their gains run on," by such an interposition of Government in their favour; the fact that many of them have suffered in the Bank failures more than they would like to do again; and the sympathy existing for ruined Shareholders would aid in making a measure to prevent such a recurrence pass easily. Such an exception has been abolished! and a measure for allowing Banks to enjoy "Limited Liability" has passed. In August 1858 it was very quietly got through, and now, under "act 21 and 22 Vict., cap. 91," Shareholders may divide the whole of their Depositors' money among themselves, and leave them their small paid-up capital instead. It is just, however, to state, that Banks of issue are made by the Act responsible for their circulation in addition to their limited liability. There is a provision also binding them to publish their accounts. The Western Bank's accounts are published, and look very well! But do Depositors in our Scotch Banks require to be warned to seek to place their money in Banks where the Shareholders are fully liable? Well, it is a pity to see men acting unreasonably, and many did so during our last panic. There are one or two Scotch Banks generally supposed to have "limited liability." Now, frequently during "the panic" of 1857 most respectable individuals were seen dragging bags

of gold out of the Banks which had a large and most undoubted proprietary, each liable to his last shilling for the debts of the Bank, to place them as Deposits in a Bank whose liability was limited! Common sense seems to say, "don't do so again." It took "*unlimited liability*" to pay the Depositors of the Northumberland and Durham District Bank 17s. 6d. per pound. Nothing less than such responsibility ought to satisfy you.

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